SPECIAL REPORT

2024 CANADA CONSTRUCTION OUTLOOK

IPA INSTITUTIONAL PROPERTY ADVISORS
A DIVISION OF MARCUS & MILLICHAP, BROKERAGE

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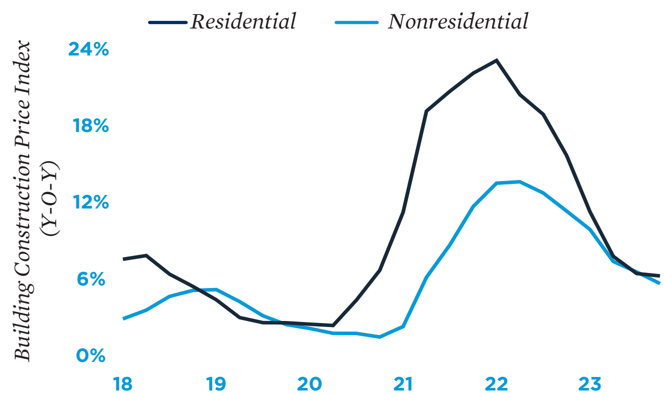
Recovery of Construction Activity In the Making as Tailwinds Gather Momentum

Easing construction costs pave path for rising building activity. Canada's construction sector faced multiple challenges after the onset of the pandemic and in the following years. The disruption of global supply chains caused steep price increases in major building materials, and the restructuring of the job market deepened labour shortages. Rising interest rates compounded these issues by making financing less accessible. These increases in construction costs squeezed development yields, narrowed the premium for new construction, and resulted in delays and sometimes outright cancellations for a variety of residential and nonresidential projects. However, some of these challenges have faded meaningfully as Canada and the rest of the world emerged from the health crisis. A recovery in construction activity is expected over the latter parts of 2024 and into 2025 as tailwinds increasingly take form.

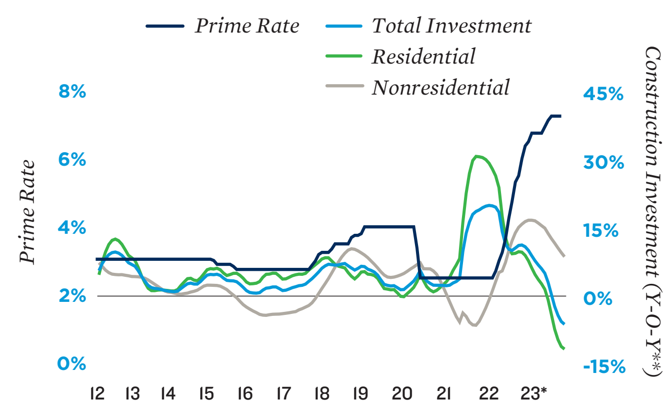
Lower cost of capital to stimulate investment. With the Bank of Canada's tightening monetary policy, developers now face hefty debt liabilities. According to CMHC's 2023 Rental Housing Supply Survey, conventional lending rates have more than doubled on average for developers since the BoC started raising interest rates in 2022. This higher cost of capital resulted in a swift deceleration in construction investment. On an annual basis, construction investment growth peaked at 20 per cent in December 2021 and has since fallen drastically. In 2024, however, construction investment may gain momentum over the latter half of the year as the BoC is widely expected to lower its overnight rate. An easier monetary environment will likely drive a rebound in residential construction investment while growth in nonresidential construction investment could accelerate following a softening in late 2023.

Moderating growth in building material prices. Over the past few years, prices for key construction materials surged due to supply chain disruptions, soaring transportation costs, multiple episodes of natural disasters and pent-up demand upon the reopening of the economy. Lumber prices rose over 60 per cent year-over-year in mid-2021, followed by concrete and cement prices increasing roughly 16 per cent and 9.0 per cent, respectively, in the summer of 2023. However, as Canada's economic growth began to slow in the second half of last year, coupled with improving global supply chains, material prices have either peaked or fallen into deflationary territory. In 2024, a soft global economic outlook should continue to put downward pressure on the price of construction materials, facilitating building activity throughout the year.

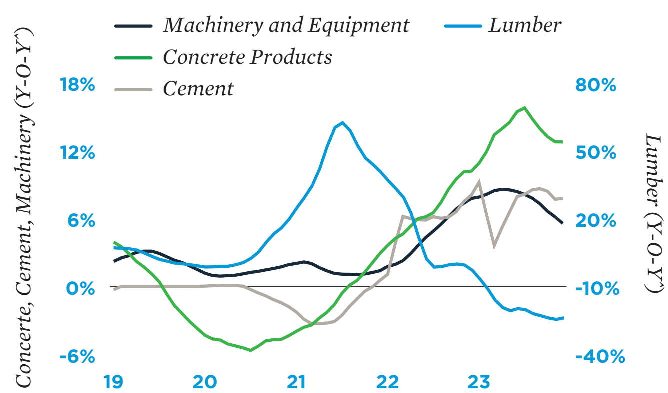
Growth of Construction Costs Decelerating



Construction Investment Set to Recover



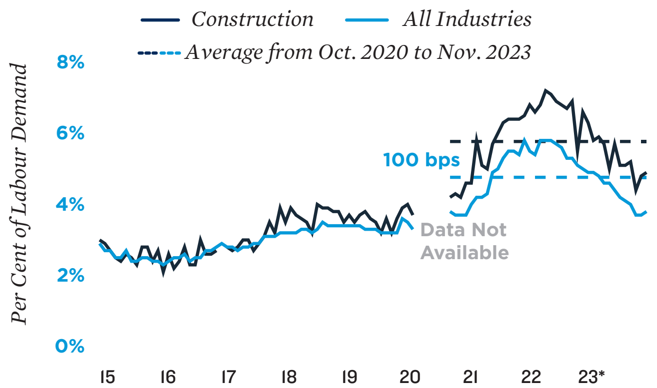
Price Growth of Major Materials Has Peaked



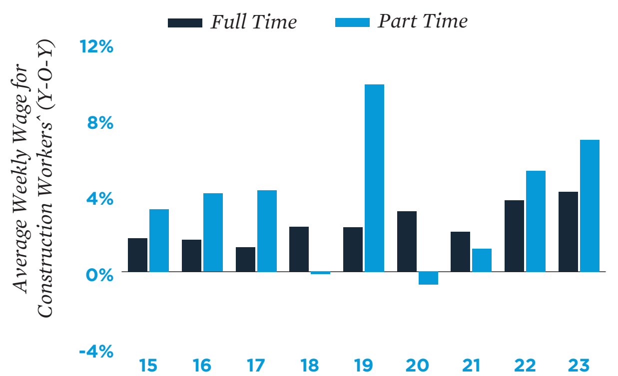
** Through November; ** Trailing 12-month; ^ 12-month average*

Sources: IPA Research Services; CMHC; Statistics Canada

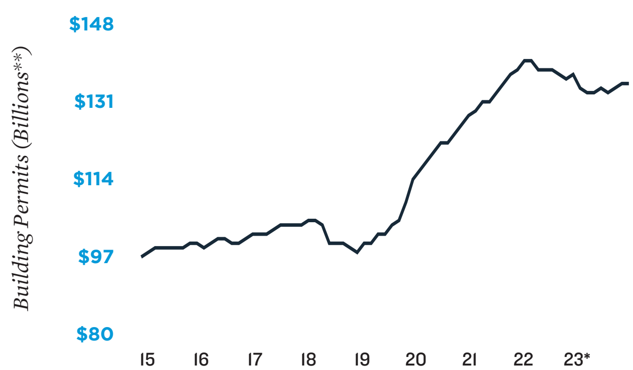
Job Vacancy Easing But Still Elevated



Mounting Wage Pressure in Construction Sector



Building Activity to Resume on Upward Trajectory



Government initiatives to increase supply. To boost construction activity, governments at all levels across Canada have introduced new laws and regulations to accelerate permit approvals. Vancouver's new 3-3-3-1 policy has led to a 30 per cent reduction in permit review times, and the city government is also pushing for a change to its single-family zoning rules to allow densification projects. Toronto's new Express Services Program enables interaction directly with permit applicants proposing smaller and less complex projects to speed up the approval process. On the national level, the federal government is considering launching a pre-approved home design catalogue, similar to its post-WWII policy, to expedite the approval process and increase housing supply via mass production. These government efforts, if well implemented, will help reduce construction delays and support development activity over the long term.

Labour shortages improving but remain a major obstacle. Canada's job vacancy rate in the construction sector has fallen significantly, down from the peak of 7.1 per cent in April 2022 to 4.8 per cent in November 2023. Nevertheless, the sector still faces worse labour shortages compared to the pre-pandemic level. From October 2020 to November 2023, the average job vacancy rate in the construction sector was 100 basis points above the national level, up from the 2019 average of just 25 basis points. Over the long run, labour shortages in the construction sector appear to be persistent. BuildForce Canada estimates that the construction industry needs nearly 300,000 new workers by 2032. This labour demand will likely be challenging to fulfill given the current economic immigration program, which targets an annual intake of just between 15,000 and 20,000 new permanent residents with trade occupations. Consequently, developers may continue to face upward wage pressure over the coming years.

Construction environment to improve in 2024. Despite ongoing labour challenges, Canada is expected to see an increase in building activity this year. Easing financial conditions, softening price growth of building materials and various governments' efforts to facilitate development will help reduce construction costs. Coupled with Canada's elevated population growth in recent years heightening demand for both residential and nonresidential spaces, the value of building permits, a leading indicator for construction activity, should return to an upward trajectory after a brief setback last year. This will translate to more construction starts in and beyond 2024, helping to improve housing affordability and better align demand and supply in tight commercial real estate sectors like industrial, multifamiliy and retail.

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** Through November; ** Trailing 12-month*
^ Wage for trades, transport and equipment operators and related occupations, except management
Sources: IPA Research Services; CMHC; IRCC, Statistics Canada

Price: $1,500